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Minimizing Risk in Global Capital Markets: A Look Ahead

Events in global capital markets in the 12 months between the spring of 1993 and the spring of 1994 were characterized by turbulence in industrial country bond markets, continuing and stepped-up attention by policymakers to regulatory and supervisory issues, and growing internationalization and institutionalization in industrial countries of government securities markets.

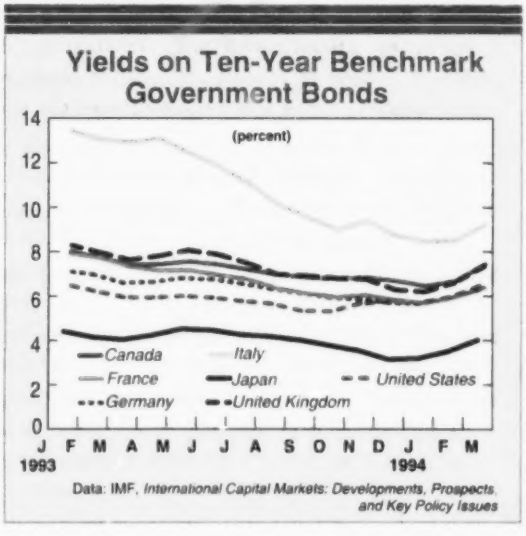
As the expansion, globalization, and integration of capital markets has continued, concerns about risk—its nature, incidence, and implications—have also grown. The IMF's forthcoming report, *International Capital Markets: Developments, Prospects, and Key Policy Issues*, in the World Economic and Financial Survey Series, reviews these recent developments and issues. (A separate report on financing for developing countries will be published later this year.)

Turbulence in Bond Markets

In the first quarter of 1994, government bond markets in the major industrial countries experienced a sharp reversal, as yields on ten-year benchmark government bonds surged, abruptly cutting off a four-year rally (see chart below). Not only was this increase in yields large, sudden, and unanticipated, but it affected many countries simultaneously.

Revised Expectations. To explain these developments, the authors of the IMF study first look at why long-term interest rates rose so much in so short a time across such a wide range of countries.

In 1993, market participants (proprietary traders, institutional investors, and dealers) began building up interest and exchange rate *(Please turn to the following page)*



Data: IMF, *International Capital Markets: Developments, Prospects, and Key Policy Issues*

Camdessus Defines IMF's Future Role

Following are edited excerpts from a press conference given by IMF Managing Director Michel Camdessus on July 18:

QUESTION: *The Bretton Woods Commission has suggested that there is a serious overlap between the work of the IMF and the World Bank in developing countries. It recommended that the IMF withdraw from some of its activities in the developing world and concentrate on managing the international monetary system. What do you think about that idea?*

CAMDESSUS: When you read the purposes of the Fund, you see no prioritization between the business of giving confidence to countries in a time of crisis and the promotion of international monetary cooperation and stable exchange markets. We have all these tasks.

With the Jamaican agreement, we entered into a floating system of currencies. The task of the IMF is to help stabilization through surveillance and promotion of cooperation of countries in converging to low inflation levels and growth. Simultaneously, we had other tasks; nothing was withdrawn.

We had encouragement, support, and requests from our entire membership to do more in fighting crises. *(Please turn to page 246)*

(continued from front page) positions based on expectations about the economic performance and future behavior of interest rates and exchange rates in Europe, the United States, and Japan. However, a series of unforeseen developments revised expectations:

- a slower-than-expected fall in European interest rates;
- stronger-than-expected growth in the United States in the fourth quarter of 1993, and an upward adjustment in interest rates in early February (the market apparently interpreted the rise in interest rates as a harbinger of future increases and an indicator of stronger-than-expected inflationary pressures);
- intensification of trade tensions between the United States and Japan, which may have signaled to the markets the U.S. authorities' willingness to tolerate a higher yen;
- in Japan, a more-buoyant-than-expected performance of equities, larger-than-expected sales of government bonds, and a less pessimistic outlook for the economy; and
- an unexpected fall in bond and equity prices in emerging markets.

Quick Market Reaction. As the authors note, if all or most market participants share the same revision of expectations, asset prices can change even without any transactions taking place. In this instance, trading volumes soared along with asset prices. Several institutional features of the market combined to ease sell-offs of previous positions, on the one hand, but to contribute to the large swing in prices, on the other:

- Financial institutions made increasing use of risk management systems designed to reduce the incidence of large losses and outright failure, but which can contribute to price swings when market sentiment is one-sided by mandating sales into a declining market.
- Insufficient liquidity prevented smaller government bond markets from quickly turning around large, accumulated positions without a significant change in yields.
- The high degree of leveraging in 1993—which permitted a buildup of

China's Capital Market Growth: A Blueprint for Developing Countries?

One of the more important financial events of the 1990s has been the growth of capital markets in China. These markets are not simply a potential new source of financing; rather, their development is "part of the cutting edge of the reform process itself," according to a forthcoming IMF study on developments in capital markets. As such, the Chinese experience provides a useful case history illustrating the challenges that developing country authorities—especially those from transitional economies lacking a tradition of private ownership—face in coordinating these markets with the overall reform effort.

Coordinating Liberalization and Stabilization. A major challenge is how to control the pace of liberalization of capital markets so that it is consistent with the continuing process of stabilization. Once economic agents become initiated into the possibilities of raising funds outside the banking system in the liberalized capital markets, it may be difficult to rein in these activities or keep them contained within official channels, according to the IMF study.

The Chinese authorities initially introduced securities markets in only a few regions on an experimental basis. In the winter of 1992/93, amid a general overheating of the economy, speculation by Chinese investors contributed to the diversion of funds from investment by state-owned enterprises to securities and real estate transactions.

The authorities responded by including in their overall stabilization program measures forcing the recall of all "speculative" loans and the complete separation of banking and securities industries. In 1993, the Government established the China Securities Regulatory Commission, to act as a centralized regulator and supervisor of securities markets.

Responding to Competition from the Liberalized Financial Sector. Liberalization of the financial sector came fairly late in the course of China's reform process. Nevertheless, the liberalized elements of the financial sector—high-yielding equities and enterprise bonds—were able to achieve an edge over the more tightly controlled bank deposits and government bonds in the competition for domestic savings. The response of the Government when these competitive pressures emerged was to hasten the liberalization of the

Major Developments

- December 1990: first recognized stock exchange officially opens in Shanghai.
- April 1991: Shenzhen Stock Exchange (SSE) opens; approximately 100 stocks listed.
- October 1993: a Chinese enterprise listed for first time on New York Stock Exchange.
- December 1993: value of equity listed on Shanghai and Shenzhen stock exchanges totals $40 billion, equal to about 3 percent of value of all emerging markets.

large positions in 1993 and contributed to the run-up in prices—acted symmetrically on the downside once bond prices began to decline.

Contagion of Increase in Interest Rates. Several relevant developments could have accounted for the widespread increase in long-term interest rates across major industrial countries. First, expectations were revised coincidentally in each of the three industrial country regions (Europe, North America, and Japan). The increasing correlation of long-term interest rates across industrial countries was not lost on market participants, and they may well have reasoned that the sharp rise in U.S. rates in early February would push rates up elsewhere in the industrial world.

Because the larger players operate simultaneously in many capital markets, losses sustained in one market may necessitate liquidations in others to maintain prespecified loss limits. In countries with insufficient liquidity to cope comfortably with selling pressure, investors resorted to "cross-hedging," which is a means of exploiting the tendency of bond yields in certain groups of countries (for example, the participants in the exchange rate mechanism (ERM)) to move together; this cross-hedging itself increased the correlation of interest rate movements across markets.

Market Performance. How well did the markets respond to this unexpected and sharp bout of turbulence? And can such incidents be prevented in the future? According to the IMF study, "this latest bout will not be the last time that market participants take a large, one-sided bet on the evolution of economic fundamentals and then abruptly alter their view in response to new information." Nor will it be the last time that some investors bet big, guess wrong, and sustain losses.

In the case of the recent turbulence, however, even though some heavily exposed investors suffered considerable losses, there were no systemic consequences. The markets did not seize up

controlled financial sector by making bank deposits and government bonds more attractive, rather than to clamp down on the liberalized markets.

Learning Financial Techniques and Discipline. The development of securities markets can serve as a means for absorbing international financial techniques and practices into the economy. The listing on an exchange, as well as market evaluation of an enterprise's stock, could, over time, provide a source of discipline on enterprise governance.

Shenzhen stock market. Capital market development is on the cutting edge of the reform process.

The Chinese authorities have introduced a multi-level disclosure policy that draws on the demand from different investor bases, rather than insisting on an absolute standard. Different categories of enterprises are held to varying degrees of disclosure standards, depending on their size and international exposure.

Separating Banking and Securities Markets. In meeting the challenge of separating these two markets, the authorities have had to weigh different types of risks. As a means of preventing banks from allocating an unduly large share of their assets to speculative activities and opening themselves up to large losses, the Chinese have prohibited banks from extending credit to participants in securities markets. On the one hand, this policy prevents bank lending from fueling speculative bubbles and involving banks in large losses when they burst. On the other hand, it probably increases transactions costs by making it necessary for investors to pay the full value of their purchases up front, and securities houses would have to hold greater reserves to protect themselves against settlement and default risk.

Listing Firms on a Stock Exchange. In contrast to most other countries, in China, securities market regulators and other government agencies select the firms that can list various types of shares on the available markets. Although this selection tends to be based on noneconomic considerations, the authorities have so far chosen the most profitable firms in the state sector. According to the authors, it may be that China's long history of central planning and controlled prices would rob foreign specialists of any comparative advantage in picking enterprises with good growth prospects.

Securities Markets as a Source of Financing. Compared to bank financing, securities markets have remained marginal as a source of domestic financing in China. In fact, the authorities recognize that banks are likely to remain the primary source of financing for enterprises for some time and have thus pushed hard for domestic bank reform.

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under the press of stepped-up transactions, and payments and settlement systems coped satisfactorily with the increased volumes of transactions. Also helping to limit systemic risk were risk management systems in individual investment institutions, with their built-in market-to-market accounting methods and explicit loss limits.

Clipping Hedge Funds. The growing influence of hedge funds over the past decade—and their active participation in the recent episode of turbulence, as well as in the 1992/93 ERM crises—has brought their activities under close scrutiny. Some observers have suggested that because of the influence and prevalence of hedge funds, they should be singled out for increased regulation; in particular, because they are less regulated than other large players in the market, which gives them greater flexibility in their investment strategies, and because they are the most heavily leveraged players in the major markets.

Each of these characteristics entail risk, but based on developments in bond and foreign exchange markets over the past few years, it seems ill-advised to single out hedge funds for special new regulatory requirements. There are, according to the study, simply too many other large players in the market that have taken similar views of market opportunities and acted accordingly to hold one group of players responsible for what happened. Also, there will be times when the flexibility hedge funds enjoy in pursuing high returns may let them act as a stabilizing force in markets when others—limited by external guidelines or conservative approaches to risk—either cannot or will not do so.

Supervising the Markets

The financial markets demonstrated their ability to bounce back from the recent episode of volatility in bond markets without serious or systemic disruption. But regulatory and supervisory authorities should not treat this resiliency as reason for complacency. "With pools of high-yield-seeking capital growing rapidly, with the technology of international capital markets making it cheaper and easier to alter the asset and currency composition of portfolios at short notice, and with institutional fund managers under continuing pressure to deliver high performance," the authors stress, the importance of systemic risk control management cannot be overemphasized.

The challenge facing supervisory authorities is to determine which activities need supervision, what sort of supervision is required, and who should do the supervising.

Concerns About the Derivatives Market. In the past several years, the derivatives market has attracted many new and inexperienced entrants. The spectacular growth of this market and the heavy losses incurred recently by several firms undertaking derivative transactions have reinforced concerns about the possible risks involved. In particular, the heavy involvement of banks in derivative market activities has signaled the need for supervisory and regulatory guidelines.

Market participants themselves, central banks, and other supervisory agencies well recognize that only the accelerated implementation of sound risk management practices can maintain the stability of the derivatives market. There is also widespread recognition of the need for continued progress in reducing the sources of systemic risk. Recent important initiatives that have been taken include:

- A proposed extension of the 1988 Basle Capital Accord. (The Basle Accord established an international framework for measuring regulatory capital and setting capital adequacy standards.) Proposals include a more comprehensive treatment of the market risk of derivative positions, including separating banks' loan and trading books; isolating market risk, including the risk of unexpected interest and exchange rate changes from specific risk; and allowing banks to reduce credit exposures through bilateral netting (that is, creating a single legally binding net position that replaces a larger number of gross obligations).
- Improved disclosure and accounting standards. More transparency about consolidated positions in the derivatives market would help lower the risk of precautionary runs based on faulty information.
- Improved market infrastructure. Initiatives include moving to real time gross settlement systems, which provide immediate finality of payments, thereby reducing settlement risk, and adopting a clearinghouse structure for netting and settling standardized over-the-counter derivatives.

Supervisory Role of the Central Bank. The IMF study suggests that the role a country's central bank should play in the supervision of banks should be based on each country's characteristics and circumstances. In an environment of fundamental and ongoing change in the financial system and in financial centers dominated by liquidity-intensive financial activities, liquidity shocks could raise systemic risks if not addressed quickly. In these situations, it may be advantageous for the central bank to assume a 'hands-on role in banking supervision.

In economies with less need for short-term liquidity management—or where banking activities are concentrated in a handful of large banks, or financial innovation is not proceeding at a rapid pace—it may be advantageous to have some other agency act as banking supervisor, provided the central bank has ready and up-to-date access to the information it needs.

Supervising Nonbanks. A related and broader question is how best to supervise and regulate the entire financial services industry in the industrial countries. Of particular concern is whether the systemic threat posed by the failure of a nonbank is as serious as that of a bank and whether the traditional separation between the supervisory approach to banks and nonbanks is still appropriate.

In many industrial countries, the "muscle" in financial markets is supplied by institutional investors (mutual funds, pension funds, hedge funds) and securities houses, rather than banks; and the lines of demarcation that once separated the activities of banks from nonbanks have grown increasingly blurred.

Nevertheless, over the past decade, the winding-down of troubled nonbanks has had little or no systemic effect, whereas when banks and other depository institutions have gotten into trouble, the systemic consequences have been substantial. Whether the difference in systemic risk between banks and nonbanks will continue in the future, as the similarity grows between bank and nonbank liabilities and assets, is open to question. The IMF study suggests that nonbank supervisors may want to pay more attention to market developments, to identifying potential systemic threats, and to international sharing and coordinating information.

Selected IMF Rates

Week Beginning	SDR Interest Rate	Rate of Remuneration	Rate of Charge
July 11	4.22	4.22	4.86
July 18	4.20	4.20	4.83

The SDR interest rate, and the rate of remuneration, are equal to a weighted average of interest rates on specified short-term domestic obligations in the money markets of the five countries whose currencies constitute the SDR valuation basket (the U.S. dollar, weighted 40 percent; deutsche mark, 21 percent; Japanese yen, 17 percent; French franc, 11 percent; and British pound, 11 percent). The rate of remuneration is the rate of return on members' remunerated reserve tranche positions. The rate of charge, a proportion (currently 115.1 percent) of the SDR interest rate, is the cost of using the IMF's financial resources. All three rates are computed each Friday for the following week. The basic rates of remuneration and charge are further adjusted to reflect burden-sharing arrangements. For latest rates, call (202) 623-7171.

Data: IMF Treasurer's Department

Government Securities Markets

An important structural change in capital markets over the past decade has been the trend toward increasing nonresident ownership of government debt. As large and recurring government fiscal deficits in the industrial countries have pushed up ratios of government debt to GDP (from about 43 percent of GDP in 1980 for the major industrial countries as a group to a projected 68 percent in 1994), the authorities have tried to find ways to minimize the cost of placing and servicing this debt. Their quest has led them to conclude that debt can be sold at low cost on the international market; but to make the debt attractive to international investors, reforms in the government securities markets are necessary.

Although the sequencing and specifics of the reforms that have been implemented differ across the major industrial countries, some consistent patterns have emerged. Of course, the sounder a country's macroeconomic fundamentals, the less difficulty it will encounter in selling bonds at a high price. Beyond that basic principle, liquidity and transparency are highly valued in the secondary market. The IMF study offers a short list of reforms and measures that have proven successful, including:

- establish a primary dealer system to underpin liquidity;
- create fungible benchmark issues in a few key maturities, because larger issues tend to be more liquid than smaller ones;
- maintain a firm, preannounced issue calendar that lets market participants operate under conditions of predictability;
- opt for open auctions, rather than issuance at fixed prices; auctions, by opening up the bidding to a wider base of investors, provide a better price;
- create a safe and efficient repurchase market to facilitate the funding of positions;
- establish an efficient securities settlement and clearance system; and
- know the investor base, since different investors have different needs.

The increase in foreign ownership of government debt has implications for the global markets that go beyond the potential reduction in debt-servicing costs for the borrower. For one thing, recourse to these markets has acted as a force to dissuade countries from imposing capital controls during times of market turbulence, since the authorities would not wish to alienate the very investors they are trying to attract. Second, many of the reforms to government bond markets listed above increase their liquidity. Strains are more likely to occur in relatively illiquid markets, and to the extent that the liquidity of government bond markets is higher today than it was ten years ago, so too is the resiliency of the system to large and sudden shifts in portfolios.

Looking Ahead

International capital markets are growing in size, sophistication, and global integration. In the past several years, according to the IMF study, these markets "have acquired clout as an indicator of the credibility of the government's actual or prospective policies, as a disciplining mechanism for inconsistent government policies, and as an impetus for reform of financial markets in industrial and developing countries alike." But, the study cautions, if international capital markets are to perform these functions successfully while avoiding the accompanying potential systemic risk, "it is important that the supervisory and regulatory framework be sensitive and responsive to the changing structure of those markets." ■

Camdessus Reviews World Economic Outlook, Suggests Ways to Meet Today's Challenges

Following are excerpts from an address on prospects and challenges facing the world economy delivered by IMF Managing Director Michel Camdessus at the Palace of Regional Government in Barcelona on July 4:

As you know, the IMF is celebrating its fiftieth birthday: in fact, the Bretton Woods Conference, at which the IMF was born, began 50 years ago this past weekend. This milestone provides a special stimulus for review and reassessment of the work of the Bretton Woods institutions, and a special stimulus for looking to the future and making sure that the IMF and World Bank are equipped for the challenges ahead. Two months ago in Madrid, I spoke about the way forward for the international monetary system, which the Fund has the responsibility to oversee. This responsibility carries with it the responsibility of surveillance over member countries' economic policies in relation to the objectives set out in our Articles of Agreement, including exchange stability, the balanced growth of international trade, and high levels of employment and real income nationally and globally. It is in this context that I would like today to consider the performance of the world economy and its prospects, the challenges that policymakers are confronting, the policy measures that are needed to address such challenges, and the help that the Fund can provide.

The Outlook and the Challenges

Just as with the IMF we have many reasons to be satisfied but much remaining to be done, so it is with the world economy.

In the *industrial countries*, inflation is at its lowest level in 30 years, and this has laid the basis for a recovery that has visibly strengthened in the course of 1994. Growth is now well established in a number of countries, including the United States, while recovery is in its earlier stages in continental Europe (including Spain) and Japan. For the industrial countries as a group, recent indicators have tended to confirm the gradual recovery of growth envisaged in the projections published by the IMF two months ago—to about 2½ percent a year in 1994 and 1995, after an average of little more than 1 percent a year during 1991–93. In fact, it appears at the present time that these projections may need to be revised upward slightly when they are recalculated in the weeks before our Annual Meetings in Madrid in October, mainly because recoveries in Europe may be stronger than projected. We expect inflation in the industrial countries, meanwhile, to remain subdued, at about 2½ percent a year on average.

This recovery of growth with subdued inflation seems a benign outlook that may provide room for optimism where the industrial countries are concerned. But, unfortunately, this is not the full story. There are also some unresolved questions, and some very obvious concerns. Let me mention just two.

The first concern relates to the sharp increases in long-term interest rates we have seen in the course of this year and the recent renewed instability in foreign exchange markets, this time in the form of downward pressure on the dollar. What do these headline-grabbing developments portend? It is important to put them in a longer-term context and to relate them also to the present conjuncture.

The increase in bond yields we have seen since the end of 1993 (about 1½ percentage points on average in the major industrial countries) has indeed been sharp, but it represents only a partial reversal of the clear downward trend seen in recent years. And an increase in yields was bound to accompany the strengthening of the recovery we have seen this year, with its implications for both credit demand and inflation risks. But the rise has surely been augmented not only by what turned out to be excessive gloom in markets last year about the persistence of the recession, which probably reduced rates to unsustainably low levels, but also this year by exaggerated fears about inflation and perhaps also concerns about long-standing fiscal policy problems. I do not view the increase in interest rates we have seen as seriously jeopardizing the recovery, but it does warn authorities that they must dispel all doubts as to the resolve of their anti-inflationary monetary stance and fiscal consolidation plans. I will return to this later.

The recent weakness of the dollar may similarly be viewed in large part as a reaction by markets to the more positive reassessment of growth prospects for Europe and Japan that has occurred in recent months. Again, there may, in my view, be some element of overreaction, which points especially to the need for the U.S. authorities to leave no doubt about their determination to curtail potential inflationary pressures. But, in any event, I would concur with the general consensus that exchange rates among the major currencies are broadly within appropriate bands, and I do not see recent developments as indicating any substantial risk of prolonged currency instability that might jeopardize prospects for continuing growth with low inflation.

I, therefore, view recent developments in foreign ex-

change and financial markets as a reflection of the essentially favorable turning point that has been passed by the industrial countries this year. These developments may contain elements of overreaction of a kind often seen when financial markets respond to a clear change in trends. And they may have provided a warning light for policymakers. But as long as authorities stick to the appropriate policies, they are surely not a serious threat to the outlook for continuing recovery.

The second concern about prospects for the industrial countries is much more real. I refer to the scourge of unemployment, which is afflicting Europe especially and no country more than Spain. In a number of European countries unemployment has risen in the recent recession to levels not seen since the 1930s, and in the industrial world as a whole more than 33 million people (more than 8 percent of the labor force) are now unemployed. This is an enormous waste of resources, a terrible ordeal for the individuals concerned, and a tear in the fabric of our societies that must be repaired. I am sometimes asked whether unemployment is a concern of the IMF, which, after all, is a monetary institution. My reply always begins with Article I of our Articles of Agreement and its reference to "high levels of employment" as a "primary objective of economic policy." Have no doubt: this is one of the Fund's central concerns, and indeed one of the central purposes of its existence.

One of the purposes of the IMF is to promote and maintain high levels of employment.

Reducing unemployment to more tolerable levels will be partly a matter of ensuring that the economic recovery now in train will be strong and durable. But the greater worry is that there is little prospect that it can be reduced to reasonable levels in the foreseeable future through economic recovery alone. For more satisfactory results to be attained, structural as well as cyclical unemployment must be reduced, and, to that end, reforms as well as recovery are required, as I shall indicate.

Let me now say a word about the developing countries and countries in transition.

Robust economic growth in many *developing countries* has been one of the most encouraging aspects of global economic trends in recent years. It was a mainstay of global growth during the recent industrial country recession, demonstrating that developing countries' economic performance is no longer so dependent on growth in the industrial world. And so in 1993, growth in the developing countries exceeded 6 percent as against little more than 1 percent in the industrial countries; and growth in developing countries' imports accounted for almost all the growth in world trade. Furthermore, developing country growth is now providing an important boost to industrial countries' exports during the recovery; this is being felt throughout Europe. In 1994–95, output in the developing world is projected to continue to advance at an annual rate of 5½–6 percent. This seems a favorable outlook, but again there are a number of concerns, and I must highlight one.

The main problem in the developing world is, of course, that economic progress has been so uneven, bypassing hundreds of millions of the world's poorest. About one in six of the population of the developing world live in countries where real per capita incomes have actually declined in the past decade, creating a "fourth world" that is concentrated in Africa. And another one in six live in countries where living standards have risen, but not fast enough to make any progress in catching up with the industrial countries. The lack of progress in all these countries is an urgent problem indeed.

In the *economies in transition*, a number of countries in Central Europe and the Baltics have begun to see a recovery of output after several years of economic decline. Indeed, in Central Europe output seems likely to rise by close to 2 percent this year—the best performance in seven years—and by almost twice this rate in 1995. All the countries that have begun to see a restoration of growth are characterized by substantial success in reducing inflation to reasonably low levels and by significant progress in structural reform.

For Russia and most other countries of the former Soviet Union, however, we are projecting further significant declines in output in 1994, for the fifth successive year. And it is clear where the problems lie. Although progress has been made in Russia and some other countries with stabilization and reform, inflation remains far too high in most cases, and economic structures continue to reflect to a large extent the distortions that go hand in hand with central planning.

On the basis of this cursory survey of developments and prospects in the world economy, I would like to suggest that among the many demanding *challenges* facing policymakers and the international community at the present time, the following four stand out:

- first, the need to make growth in the industrial countries stronger and more secure for both the short term and the long term while—as it, in fact, implies—consolidating the gains made in cutting inflation;

• second, the need for a sharp reduction in structural unemployment in the industrial countries;

• third, the need to establish sustainable growth and reduce poverty throughout the developing world, and especially in the "fourth world"; and

• fourth, the need to secure growing market economies in all the countries in transition.

Policies Needed to Meet the Challenges

The first challenge is to *make the recovery in the industrial countries stronger and more durable*. Both fiscal and monetary policies have essential roles to play.

Regarding fiscal policy, the lessons of recent experience are, I believe, clear. Most industrial countries—Japan being the main notable exception—entered the recent recession with large budget deficits and high debt/GDP ratios, partly as a result of failures to persevere with fiscal consolidation when activity was strong in the late 1980s. As a result, their ability to use short-term fiscal stimulus to support demand during the recent recession was severely constrained, and this contributed to the duration and severity of the recession itself. Nevertheless, most countries' fiscal positions deteriorated further in the past few years, for both cyclical and structural reasons. I am sure that this story is not unfamiliar to you, because the experience of Spain is quite close to the average experience of all industrial countries. On average, net government debt in the industrial countries reached almost 40 percent of GDP last year from about 32 percent in 1989, and the corresponding figures for Spain are 42 percent and 31 percent.

From this experience, it is clear and, I believe, increasingly well recognized in most countries, including Spain, that fiscal policy can best help to strengthen and prolong the present recovery through the adoption of specific programs of medium-term fiscal consolidation. Many industrial countries are now in the process of implementing such plans, but more ambitious efforts are needed in many cases to reverse the rise in debt ratios and restore fiscal sustainability.

Regarding monetary policy, substantial reductions in short-term interest rates have been made possible during the recession by the decline of inflation, and they have been providing an essential part of the impetus behind the recovery. The process of reducing short-term interest rates has already ended and gone into reverse in the United States, and it seems close to an end in most other industrial countries, although there appears to be some scope for further reductions in some European countries, as well as Japan.

Looking to the role of monetary policy in strengthening the recovery, I believe it is clear that its main task must be to protect—and indeed extend—the hard-won gains achieved over the past decade in lowering inflation. Monetary authorities must protect and strengthen their anti-inflationary credibility in order to lower expected inflation and help reduce long-term interest rates. The authorities must take prompt action to fend off prospective inflationary pressures as economic slack is reduced. Recent experience in the United States—where the rise in long-term interest rates and weakness of the dollar may be interpreted as indicating a deterioration in inflation expectations—shows the importance of acting sooner rather than later. In the EMS, some degree of exchange rate flexibility may again be helpful during the recovery, to the extent that inflationary pressures diverge among countries and thus call for different monetary policy responses.

By strengthening the recovery in these ways, fiscal and monetary policy will make important contributions to the reduction of joblessness, not only by reducing its cyclical component but also by preventing recent cyclical increases in unemployment from becoming entrenched and structural. But a strong and durable recovery will not be sufficient to attain the reduction in unemployment that we need.

This is why our second challenge is to *reduce structural unemployment* in the industrial countries. I believe that there is now little dispute among policymakers on what needs to be done. Radical structural measures are needed to make wages more flexible; to limit taxes and government regulations that discourage employment; to reform unemployment benefit systems in order to reduce disincentives to work and promote job search; and to improve both the incentives and the opportunities to upgrade skills, which means devoting more resources to education, training, and retraining.

Unfortunately, of course, existing arrangements and rigidities, which often have their origin in well-meaning efforts to protect the unemployed and people in low-paid and insecure jobs, tend to be backed by a social consensus that makes reform difficult. However, I believe that the needed change in attitudes is occurring. Policies to increase the flexibility of labor markets have recently been adopted in a number of European countries, and I should like to pay particular tribute to the courage of the Spanish authorities in recently embarking on their efforts. Given the scale and depth of this country's unemployment problem, more will surely need to be done; but the legislation that has recently come into force is a substantial step forward.

The third challenge—and perhaps the most daunting and pressing of all—is to *establish sustainable growth in the developing countries that have failed to progress in recent decades*. Their problems are indeed complex, but it is clear is that they can draw great encouragement from the 40 or so countries that have achieved success. These range from Argentina to

Bangladesh, from Mexico to Ghana and Nepal. The accumulation of evidence of the success of such strategies has contributed to a growing consensus over the past decade on the approach that is required. And its ingredients are clear:

- first, rigorous macroeconomic policies: a firm anti-inflationary monetary policy, a sound and sustainable fiscal position, and a realistic exchange rate;
- second, structural policies and a development strategy that make the most of the benefits of a competitive market system but also provide for the government to intervene where appropriate—for example, to invest in infrastructure and human capital, and to protect the environment;
- third, a liberal trade and exchange regime that provides openness to trade and investment to secure the benefits of full participation in the global economy;
- fourth, social policies—to help ensure broad-based participation by the population in economic and social life. I include here policies to alleviate poverty, protect the most vulnerable, and slow down excessive population growth; and
- last but not least, all elements of good governance, including public accountability, participatory government, and legal and regulatory frameworks that are transparent and fair. Such policies in the developing countries themselves provide the key to high-quality growth. But, of course, the assistance of the international community is also essential.

We need to establish sustainable growth and reduce poverty throughout the developing world.

The fourth challenge is to *secure growing market economies in all the countries in transition*, including Russia and the other countries of the former Soviet Union. The policies required to meet this challenge are to be found in the experience of the transition economies where the growth of new market economies has begun. These countries have implemented with determination and consistency the policies that the transition to a market economy inescapably entails: prices have to be freed; the economy has to be opened to the rest of the world; macroeconomic stability has to be established after the initial, unavoidable jump in prices; laws and institutions have to be reformed; enterprises have to be commercialized and privatized; and the poor and vulnerable have to be protected. All these are, of course, immense challenges.

The main stumbling blocks to successful transformation in most countries, including Russia, have been inadequate progress with both macroeconomic stabilization and enterprise reform, and the interaction between them. Thus, insufficiently firm fiscal and monetary policies have not only continued to fuel inflation but also distorted price signals and economic incentives and delayed the crucial restructuring of the enterprise sector. Conversely, lax financial policies can be partly attributed to insufficient progress in restructuring enterprises and the failure of authorities to resist pressures from enterprises for subsidies and credits. The lesson is clear: governments must limit total financial support to enterprises to a level consistent with overall budget objectives and with the need to make room for adequate government expenditures on infrastructure, social safety nets, and other priority areas. And, at the same time, they must proceed with enterprise and other structural reforms.

All the challenges I have described—challenges facing industrial, developing, and transforming countries—call for international cooperation as well as the application of the appropriate national policies as I have outlined. The IMF is one of the institutional pillars of the system of multilateral economic cooperation that was established 50 years ago, and it has a role to play in every case.

International Cooperation and the IMF's Role

The IMF performs its role by providing, through its surveillance function, policy advice to all 178 of its member countries; by providing technical assistance to member governments in its areas of expertise; and by providing temporary financial assistance to countries in balance of payments difficulties to ease adjustment and support sustainable growth.

At the present time, there are 51 countries with financial arrangements in place with the Fund, and 20 others are engaged in negotiations or preliminary discussions with a view to signing new arrangements in the next few months. There have recently been two significant developments in the Fund's financing facilities. Last year, the systemic transformation facility (STF) was introduced specially to assist the countries in transition. In addition, early this year, the Fund's concessional facility for low-income countries, the enhanced structural adjustment facility (ESAF), was enlarged and extended.

Furthermore, on the basis of the guidance of the Interim Committee, the Fund is now working toward further adaptations of its financial instruments to meet the needs of our members and the challenges of our time. I hope that before our Annual Meeting in Madrid, our membership will reach agreement on a response that will entail a significant temporary extension of the access limits—that is to say, the amounts we are authorized to disburse in support of strong economic programs; an extension and adaptation of the STF; and—at last, I might add—an allocation of special drawing rights (SDRs). ■

Group of Seven Communiqué

Leaders Discuss Jobs, Role of Bretton Woods Institutions

Following are excerpts of the Group of Seven economic declaration issued in Naples on July 9:

Fifty years ago, at Bretton Woods, visionary leaders began to build the institutions that provided our nations with two generations of freedom and prosperity. They based their efforts on two great and abiding principles—democracy and open markets.

As we approach the threshold of the twenty-first century, we are conscious of our responsibility to renew and revitalize these institutions and to take on the challenge of integrating the newly emerging market democracies across the globe.

To carry out this responsibility, we have agreed that, in Halifax next year, we will focus on two questions: (1) How can we assure that the global economy of the twenty-first century will provide sustainable development with good prosperity and [the] well-being of the peoples of our nations and the world? (2) What framework of institutions will be required to meet these challenges in the twenty-first century? How can we adapt existing institutions and build new institutions to ensure the future prosperity and security of our people?

Jobs and Growth

A year ago, recovery was absent or hesitant in all our economies. Today, recovery is under way. New jobs have been created, and in more and more of our countries people are getting back to work. Inflation is now at the lowest levels in over three decades, and the conditions are in place for strong and lasting noninflationary growth. Therefore, we reconfirm the growth strategy we agreed in Tokyo. We call on our finance ministers to cooperate closely to keep recovery on track, and we have asked them to enhance the ongoing process of multilateral surveillance and policy cooperation. We also encourage stronger cooperation between our appropriate authorities to respond to the growing integration of the global capital markets.

But unemployment remains far too high, with over 24 million unemployed in our countries alone.

Following the jobs conference in Detroit and the analysis of the OECD [Organization for Economic Cooperation and Development], we have identified the actions we need to take:

- We will work for growth and stability.
- We will build on the present recovery by accelerating reforms to improve the capacity of our economies to create jobs.

Trade

Opening markets fosters growth, generates employment, and increases prosperity.

The signing of the Uruguay Round Agreements and the creation of the WTO [World Trade Organization] are milestones in postwar trade liberalization.

We are determined to ratify the Uruguay Round Agreements and to establish the WTO by January 1, 1995, and call on other countries to do the same.

We are resolved to continue the momentum of trade liberalization.

We call on the WTO, IMF, World Bank, and the OECD to cooperate within their own areas of responsibility.

Developing Countries

We welcome the economic progress of many developing countries. We are concerned, however, by the stagnation and continued poverty in some countries, particularly in Africa. Since rapid population growth has aggravated poverty in many countries, we stress the importance of a positive outcome of the Cairo Conference on Population and Development.

We are committed to continue our efforts to enhance development assistance as well as promoting trade and investment in developing countries.

We are encouraged by significant private capital flows to developing countries and by the efforts of many of these countries, particularly in Latin America and Asia, to increase trade among themselves.

We call on the World Bank, as well as the regional development banks, to strengthen their efforts to reinforce private capital flows to the developing world while providing growing resources for health, education, family policies, and environmental protection.

We encourage the Paris Club to pursue its efforts to improve the debt treatment of the poorest and most indebted countries. Where appropriate, we favor a reduction in the stock of debt and an increase in concessionality for those countries facing special difficulties.

We welcome the renewal of the ESAF and the measures under consideration by the IMF to increase support to developing countries and to ensure that all members take part in the SDR system. In addition, we agree to explore ways to mobilize more effectively the existing resources of the in-

ternational financial institutions to respond to the special needs of countries emerging from economic and political disruption and the poorest, most indebted countries.

Ukraine

We are deeply concerned about the economic situation. Genuine reform is the only way to improve the economy. We urge the Ukrainian Government to design and implement rapidly stabilization and structural reforms, including price liberalization and privatization.

This would provide the basis for IMF lending and for substantial loans by the World Bank and the EBRD [European Bank for Reconstruction and Development].

Russia

We are encouraged by the commitment to reform of the Russian leadership and by the progress made so far.

The approach we endorsed in Tokyo last year is producing results. We welcome the agreement with the IMF on an economic program and the recent series of loan agreements with the World Bank and the EBRD. We encourage Russia to work with the international financial institutions to stabilize the economy, reinforce the reform process, and reduce social hardship.

The increases in IMF limits, provision of SDRs to new IMF members, and acceleration of World Bank lending that are now under consideration will significantly augment the ability to support Russian reform efforts. The recently agreed comprehensive rescheduling of Russia's 1994 debt obligations will also help.

Other Countries in Transition

We commend the political and economic transformation of the Central and Eastern European countries and support their integration into the free market. ■

From the Executive Board . . .

PHILIPPINES:

Medium-Term Credit

The IMF today approved a credit for the Philippines totaling the equivalent of SDR 474.5 million (about $684 million) under the extended fund facility (EFF). The credit is being made available over the next three years to support the Government's medium-term economic and financial reform program.

Background

By the end of 1992, the Philippines had succeeded in liberalizing the economy, and considerable progress was achieved in reducing macroeconomic imbalances and addressing underlying structural weaknesses. In 1993, while growth improved, aggregate demand grew even faster, fed by a surge in domestic liquidity and an increase in the public sector deficit. Consequently, the external current account deficit increased to about 6 percent of GNP, net international reserves declined, and by early 1994 the 12-month rate of inflation accelerated to around 10 percent from 6.6 percent in June 1993, the lowest rate since 1987.

Medium-Term Strategy

The Government's medium-term program has three main objectives: to lift the Philippines' growth rate from 2.3 percent in 1993 to about 6 percent by 1997, consistent with levels achieved by its other ASEAN neighbors; to bring inflation down to about 4 percent, thereby enabling competitiveness to be maintained with a stable exchange rate; and to achieve balance of payments viability by reducing the external current account deficit from 6 percent of GNP in 1993 to a sustainable level of about 2.5 percent of GNP by 1997.

The authorities' policy strategy will focus on four main areas. First, fiscal consolidation, to place public finances on a sound footing through sustained reductions in the public sector deficit and domestic debt. Second, financial reform, aimed at reinvigorating the banking system by opening it to foreign competition and reducing taxation on intermediation. Third, macroeconomic stabilization, to reduce external imbalances and lower inflation through consistent and appropriate financial policies. Fourth, economic liberalization, to expand and strengthen the private sector. In this regard, the oil sector will be deregulated, virtually all quantitative import restrictions will be removed, and the privatization program completed.

The main aims of the 1994 program are to achieve a growth rate of about 3.5–4.5 percent, to reduce inflation to 8.5 percent by year-end, and to limit the current account deficit to under 5 percent of GNP, while rebuilding gross international reserves to 3.4 months' worth of imports. While fiscal policy will remain essentially unchanged, monetary policy initially will be tightened and then maintained on a steady course consistent with the targeted inflation rate.

Addressing Social Costs

While poverty remains a formidable problem, particularly in rural areas, a number of steps are being taken that should ameliorate the situation. These include implementation of the Comprehensive Agrarian Reform Program, which in 18 months has distributed 858,000 hectares of farmland to the poor. Also, the PRO-POOR program has been expanded and

Philippines: Selected Economic Indicators

	1991	1992	1993[1]	1994[2]	1995[2]	1996[2]	1997[2]
				(percent change)			
Real GNP	0.4	1.0	2.3	3.5	4.0	5.0	6.0
Consumer price inflation (annual average)	18.7	8.9	7.6	9.5	6.0	4.5	4.0
				(percent of GNP)			
External current account balance	–2.2	–1.8	–5.9	–4.8	–3.8	–3.0	–2.6
Consolidated public sector balance	–2.1	–2.0	–2.7	–2.2	–1.0	–0.6	–0.5

[1] Preliminary.
[2] Program.

Data: IMF staff estimates

revamped so as to direct social services and infrastructure programs toward the most needy municipalities. Other policies in the social sector center on improved health and nutrition services, particularly for children, and on providing affordable housing to the poor.

The Challenge Ahead

In marked contrast to previous IMF-supported programs, the external financing assurances for this program are strong. The debt-service burden is manageable and likely to decline, while the Fund's involvement is likely to catalyze funds from other sources, including the private capital markets. The most important assurance, however, remains the commitment of the authorities to ensure that the Philippines rejoin the ranks of its fast-growing ASEAN neighbors. The authorities intend to monitor the progress of policies very closely, including through six-monthly reviews that will focus on progress in implementing the key structural measures.

The Philippines joined the IMF on December 27, 1945, and its quota is SDR 633.4 million (about $914 million). Its outstanding use of IMF credit currently totals the equivalent of SDR 821 million (about $1,184 million).

Press Release No. 94/43, June 24

NICARAGUA: ESAF

The IMF today approved a three-year loan for Nicaragua in an amount equivalent to SDR 120.12 million (about $173 million) under the enhanced structural adjustment facility (ESAF) to support the Government's medium-term economic and reform program during the period 1994–97. The first annual ESAF loan, in an amount equivalent to SDR 40.04 million (about $58 million), will be disbursed in two equal semi-annual installments, beginning July 1, 1994.

Background

Following a prolonged period of economic instability created by civil war and marked by falling output and extremely high levels of inflation, the Nicaraguan Government embarked on a comprehensive economic reform program in 1991 supported by a stand-by arrangement from the IMF. This program resulted in a rapid deceleration of inflation from 13,500 percent in 1990 to an annual rate of 4½ percent in the period May–December 1991, and an improvement in the country's foreign reserve position. Further gains were registered in 1992, as inflation remained low and several structural reforms were implemented, including the privatization of a large number of public entities. At the same time measures were adopted to liberalize the financial system and improve the performance of state-owned banks. Economic gains in 1993, however, were more limited. Fiscal performance was weaker than envisaged, there were shortfalls in external assistance, and the international reserve position deteriorated.

Medium-Term Strategy

To address the remaining obstacles facing Nicaragua's economy, the Government has adopted a comprehensive medium-term program for 1994–97 that aims to consolidate the gains achieved in the past, deepen structural reforms, and move toward external viability. The main objectives of the program are to achieve growth in real per capita income of 1 to 1½ percent a year by 1996; reduce inflation to about 5 percent a year by 1997; and strengthen the reserve position to 3½ months of imports by the end of 1996.

Within this medium-term framework, the 1994–95 program, supported by the first annual ESAF loan, aims at achieving real GDP growth of 2 percent in 1994 and 3 percent in 1995; limiting inflation to 10 percent in 1994 and less than 8 percent in 1995; and increasing gross international reserves to 2½ months of imports by the end of 1995. To achieve these objectives, fiscal policy is designed to strengthen the savings position of the combined public sector by close to 4 percentage points of GDP in 1994–95 through several revenue actions and improvements in tax and customs administration. Public sector prices will also be adjusted, a voluntary employment reduction program implemented, spending on nonessential items curtailed, and certain government entities closed or streamlined to effect further savings. Credit and monetary policies are designed to be

NICARAGUA: Selected Economic Indicators

	1992	1993	1994[1]	1995[1]	1996[2]
	(percent change)				
Real economic growth	0.4	–0.9	2.0	3.0	4.5
Consumer price index (end of period)	3.5	19.5	10.0	7.7	6.0
	(percent of GDP)				
External current account balance (excluding official transfers and interest obligations)	–30.7	–23.8	–22.6	–20.2	–17.4
Overall public sector balance (before grants)	–9.9	–9.9	–9.7	–7.2	–6.3

[1] Program.
[2] Projected.

Data: Nicaraguan authorities and IMF staff estimates

Recent Use of IMF Credit

(million SDRs)

	During June 1994	Jan.–June 1994	Jan.–June 1993
General Resources Account	474.16	2,930.35	2,314.55
Stand-by arrangements[1]	99.61	641.39	743.85
EFF arrangements	88.15	497.88	1,541.07
CCFF	274.32	295.82	13.50
STF	12.08	1,495.26	16.13
SAF and ESAF arrangements	14.70	485.65	106.90
Total	**488.86**	**3,416.00**	**2,421.45**

Note: EFF = extended Fund facility.
CCFF = compensatory and contingency financing facility.
STF = systemic transformation facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals shown because of rounding.
[1] Includes drawings in first credit tranche.

Data: IMF Treasurer's Department

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consistent with the program's balance of payments and inflation targets.

Structural Reforms

Structural reforms are a key element of the program. These include specific measures aimed at resolving the property rights issue to establish the basis for private investment and sustained economic growth; continuing the privatization of state-owned corporations, reducing the high operating costs of state-owned banks and improving loan recoveries; and implementing labor market reforms to increase flexibility.

Addressing Social Problems

The Government is giving priority to strengthening its social programs and will focus on improving the provision of basic services, particularly primary health care and education, as well as on poverty alleviation programs targeted on the most vulnerable groups of society. Poverty alleviation programs include the Emergency Social Investment Fund, which in 1994–96 is expected to double its expenditure tied to external assistance compared with 1991–93; the National Reconciliation and Rehabilitation Program, which supports regions affected by the civil war; and the Community Employment Fund. The Government has also formulated an environmental action plan to address the problems of water pollution, deforestation, soil erosion, and the deterioration of coastal and marine ecosystems.

The Challenge Ahead

Setting the basis for sustained economic recovery in Nicaragua involves an adjustment process that will take several years to complete and will require profound structural changes. In view of Nicaragua's substantial debt-service burden, the country's exceptional financing needs are expected to remain very high over the medium term, and the rescheduling of obligations on highly concessional terms, as well as debt and debt-service reduction by official and commercial creditors, will be required.

Nicaragua joined the IMF on March 14, 1946, and its quota is SDR 96.1 million (about $139 million). Nicaragua's outstanding use of IMF credit currently totals SDR 17.0 million (about $25 million).

Press Release No. 94/44, June 24

Stand-By, EFF, SAF, and ESAF Arrangements As of June 30, 1994

(million SDRs)

Member	Date of Arrangement	Expiration Date	Amount Agreed	Undrawn Balance
Stand-by arrangements			**1,873.04**	**1,425.95**
Algeria	May 27, 1994	May 26, 1995	457.20	411.50
Bulgaria	April 11, 1994	March 31, 1995	69.74	46.49
Cameroon	March 14, 1994	September 13, 1995	81.06	59.15
Central African Rep.	March 28, 1994	March 27, 1995	16.48	5.77
Chad	March 23, 1994	March 22, 1995	16.52	6.20
Congo	May 27, 1994	May 26, 1995	23.16	10.66
Ecuador	May 11, 1994	March 31, 1996	130.00	130.00
El Salvador	May 10, 1993	December 31, 1994	47.11	47.11
Estonia	October 27, 1993	March 26, 1995	11.63	9.30
Gabon	March 30, 1994	March 29, 1995	38.60	33.09
Hungary	September 15, 1993	December 14, 1994	340.00	283.30
Kazakhstan	January 26, 1994	January 25, 1995	123.75	111.38
Latvia	December 15, 1993	March 14, 1995	22.88	22.88
Lithuania	October 22, 1993	March 21, 1995	25.88	20.70
Moldova	December 17, 1993	March 16, 1995	51.75	30.00
Niger	March 4, 1994	March 3, 1995	18.60	7.49
Panama	February 24, 1992	September 23, 1994	74.17	19.60
Romania	May 11, 1994	December 10, 1995	131.97	94.26
Senegal	March 2, 1994	March 1, 1995	47.56	18.65
Viet Nam	October 6, 1993	December 31, 1994	145.00	60.44
EFF arrangements			**5,106.38**	**2,278.58**
Argentina	March 31, 1992	March 30, 1995	2,483.15	556.10
Egypt	September 20, 1993	September 19, 1996	400.00	400.00
Jamaica	December 11, 1992	December 10, 1995	109.13	45.75
Jordan	May 25, 1994	May 24, 1997	127.80	117.97
Pakistan	February 22, 1994	February 21, 1997	379.10	298.55
Peru	March 18, 1993	March 17, 1996	1,018.10	375.41
Philippines	June 24, 1994	June 23, 1997	474.50	438.00
Zimbabwe	September 11, 1992	September 10, 1995	114.60	46.80
SAF arrangements			**76.44**	**14.12**
Ethiopia	October 26, 1992	October 27, 1995	49.42	14.12
Sierra Leone	March 28, 1994	March 27, 1995	27.02	--
ESAF arrangements			**2,664.62**	**1,564.67**
Albania	July 14, 1993	July 13, 1996	42.36	25.42
Benin	January 25, 1993	January 24, 1996	51.89	27.18
Burkina Faso	March 31, 1993	March 30, 1996	48.62	30.94
Burundi	November 13, 1991	November 12, 1994	42.70	23.49
Cambodia	May 6, 1994	May 5, 1997	84.00	70.00
Côte d'Ivoire	March 11, 1994	March 10, 1997	333.48	273.93
Equatorial Guinea	February 3, 1993	February 2, 1996	12.88	8.28
Guinea	November 6, 1991	November 5, 1994	57.90	40.53
Honduras	July 24, 1992	July 23, 1995	40.68	27.12
Kenya	December 22, 1993	December 21, 1994	45.23	22.62
Lao P.D.R.	June 4, 1993	June 3, 1996	35.19	23.46
Lesotho	May 22, 1991	August 1, 1994	18.12	--
Mali	August 28, 1992	August 27, 1995	79.24	44.19
Mauritania	December 9, 1992	December 8, 1994	33.90	8.48
Mongolia	June 25, 1993	June 24, 1996	40.81	22.26
Mozambique	June 1, 1990	June 14, 1995	130.05	14.70
Nepal	October 5, 1992	October 4, 1995	33.57	16.79
Nicaragua	June 24, 1994	June 23, 1997	120.12	120.12
Pakistan	February 22, 1994	February 21, 1997	606.60	505.50
Sierra Leone	March 28, 1994	March 27, 1997	88.78	25.28
Sri Lanka	September 13, 1991	March 29, 1995	336.00	56.00
Tanzania	July 29, 1991	July 28, 1994	181.90	96.30
Zimbabwe	September 11, 1992	September 10, 1995	200.60	82.10
TOTAL			**9,720.48**	**5,283.32**

Note: EFF = extended Fund facility.
SAF = structural adjustment facility.
ESAF = enhanced structural adjustment facility.
Figures may not add to totals shown because of rounding.

Data: IMF Treasurer's Department

Camdessus Cites Developing Countries as Partners

(continued from front page) We had a degree of indifference from major countries, in particular, to our role in promoting international cooperation for stable exchange rates. I say a degree of indifference with a certain sense of understatement, perhaps.

The basic question for us is not to reduce our commitment to helping countries correct their balance of payments disequilibria and improve their situation in times of crisis, but to add to that a more effective contribution to market stability and growth. This cannot be done without active support and encouragement from the entire membership—particularly from the countries responsible for the key financial centers.

Here we are at the heart of the problems of the next few years. We are now in a universe of globalization where a central role for cooperation, and convergence toward stability and growth, is needed more than ever.

QUESTION: *Has the IMF's relationship with developing countries gradually evolved from clientship to global cooperation?*

CAMDESSUS: Our relationship with developing countries is evolving in that welcome direction. I have many times referred to the remarkable performance of 40 successful developing countries that have applied our recommendations with perseverance. In 1993, they provided almost the entire growth of output and trade of the world.

These countries are no longer clients; they are important partners in world international cooperation. These countries will provide something like 35–40 percent of world output growth during the next five years.

This being said, there remains more or less one third of the population of the developing world where this positive effect of structural adjustment has developed insufficiently or not at all. For these countries, of course, the traditional relations between the IMF and its members—based on the sound principle of conditionality and support, and depending on the quality of policies—will have to prevail. This does not change their status as partners in the exciting task of promoting global growth and stability.

QUESTION: *Is there any concern on your part that this persistent weakness of the dollar is going to undercut signs of emergence of economic recoveries in Europe and Japan? Is it worrisome enough to require further actions by the United States, Germany, Japan?*

CAMDESSUS: Relative to the yen in particular, we have seen a sharp fall of the dollar recently, even if this fall has been less relative to other currencies—on a trade-weighted basis the U.S. dollar is near the middle of its range of movement of the past few years.

This being said, each time you have important developments in exchange markets, even in a regime of floating free markets, this must always ring a bell. The U.S. economy is running at potential and continuing to expand at a reasonably rapid pace. A question can be raised about the so-called neutrality of monetary policy in that context. Also, after the important efforts of last year, the United States still has an incomplete agenda for fiscal consolidation. One could expect the U.S. authorities in the following weeks or months to adapt their economic policies to respond to that question.

I do not see that present developments in the exchange markets have the potential to undercut recovery in Europe and Japan. The recovery in Europe is moderate and relatively slow, but broad-based enough to resist these developments. But one must be careful. In the case of Japan, we have seen in other circumstances the effects of a sharp appreciation of the yen on the beginning of a phase of recovery. No doubt the Japanese authorities will be careful about that. We would tend to think that reaction on their side, possibly through the use of monetary instruments, could be in order.

In Europe, our diagnosis and recommendations have not changed. We still believe that there is room for some prudent reduction in interest rates in Europe, following the improvement of the results of the fight against inflation; but there is no more room than earlier, as the recovery is now well on its way. What all of this suggests is certainly a close coordination of efforts among all these key countries, and a common perseverance in taking advantage of the present recovery to address the basic problem they have, particularly in Europe and in the United States—namely, fiscal consolidation.

QUESTION: *What are the priorities for the IMF in the next five years? And do you envisage a decision-making process in which developing countries will have a say on global economic issues?*

CAMDESSUS: During the next five years, we will continue to be inspired by the purposes of the Fund. We will try to complete with the other third of the developing countries what we have done with two thirds of them—I speak here in terms of population—namely, put them on a path of sustainable growth. This is, of course, a major task, a task we will not be able to complete without them. Once again, partnership is the key word. I hope that peace conditions, in particular, permit further progress.

We must also consolidate the achievements of those on a path of sustainable growth, because we know how success is always fragile; when you start improving the economic and social structures of a country, you discover more and more problems.

We must help industrial countries make further progress toward converging low rates of inflation, higher rates of growth, stronger fiscal consolidation, more flexibility in their structures, more flexibility in labor markets, and so on.

We must also bear in mind that the world is changing and that we must adapt ourselves to the phenomenon of globalization. This will certainly mean a major effort by all countries to integrate themselves more effectively with the mainstream of the successful world economies. This implies removing remaining obstacles to trade, and to the movement of persons and capital. Here we have an immediate task for the IMF.

At Bretton Woods we were entrusted with providing for the convertibility of current account transactions. We are accelerating progress in that direction. But if we look at the prospects for globalization, what is important is not only current account convertibility but also capital account convertibility.

Our founders never imagined this, so our Articles of Agreement provide the possibility for each country to restrict capital transactions. But history shows us that with globalization there is a lot to gain in fully opening the doors to capital transactions. But it must be done carefully, in a framework of good macroeconomic policies and efforts to put in place the appropriate structures. It is an important business; we believe now it is time for the IMF to go the extra mile.

We also know that globalized markets facilitate a broad and easier equilibrium between savings and investment in the world, and channel resources to the best opportunities for productive investment. But crises can suddenly put at risk even countries with sound macroeconomic policies and a good record of implementation. I intend to circulate proposals this summer to the IMF's Executive Board for a very short-term facility to help countries with sound macroeconomic policies if they suffer from such problems.

Another relevant point is new thinking about the role of the SDR. A globalized world economy would certainly benefit from a globalized world monetary unit. There are good reasons for us to think about the need for, and the modalities of, a world monetary unit.

Lastly, the world is very different. Now we have developing countries playing a decisive role in growth and trade development. It is crystal clear that we must have developing countries play the role their economic importance amply justifies.

The Interim Committee, for example, is a remarkable framework for participatory decisionmaking. The 24 ministers of finance meet twice a year and have great potential to deepen their common work. All share the sense that there are dimensions of their national responsibilities that depend heavily on globalization. I attach high importance to proposals to strengthen and develop a new role for the Interim Committee.

QUESTION: *We were told in Naples that various changes the Group of 7 was recommending for the IMF would amount to $3.5 billion in new money for Russia. Do you agree with that estimate? Will there be a stand-by agreement with Russia by the fall?*

CAMDESSUS: I must tell you the figure of $3.5 billion has no status at all. What has been alluded to in the Naples communiqué is to what we call "the package," which involves following up the deliberations of the Interim Committee of last April. The Interim Committee invited us to consider an extra effort in support of countries in transition and developing countries embarking on far-reaching and comprehensive programs. We simultaneously looked at the contribution an SDR allocation could provide.

With regard to our facilities, there are proposals for a temporary increase in access under stand-by and extended arrangements. Provided countries come to us with strong programs, we thought that we could raise the access limit from 68 percent to 90 percent a year. We also thought we could provide greater access to our concessional resources under ESAF [enhanced structural adjustment facility] arrangements when cases warrant it.

We are considering a one-year extension of our systemic transformation facility and a new tranche, raising the overall access limit from 50 percent to 80 or 85 percent, provided the third tranche comes with drawings under a stand-by or an extended arrangement.

Simultaneously, we are working on the SDR allocation, and here we have two approaches. The first is a special allocation, which tends to re-establish equity in our membership by giving a share in the SDR system to countries that have joined the Fund since 1981, the date of our last allocation.

But the big majority of our Executive Board considers that there is, in their judgment and also in my judgment, a global need for supplementing reserves in the system, and that the case for a general SDR allocation is well made.

My personal guess is that we are moving toward a package that includes measures to strengthen our instruments and a mix of special and, I hope, general allocation of SDRs. This very strong and substantial pack-

age would give us the ability to do our job better, at least during the next three years.

I would like to emphasize the key principles behind this package: The first principle is even-handedness—we do not target a group of countries; this applies to all, provided—second principle—that they come to us with strong programs. The third principle is well-designed conditionality. And, last, the catalytic principle. The IMF can do a bigger part of the job, but this can make sense only if the IMF catalyzes the contribution of other creditors, bilateral and multilateral, and donors.

This is the package. I was happy to see that the Naples Summit endorsed this approach and encouraged us to continue in this direction.

How much it provides Russia will depend on the size of the SDR allocation, and on the distribution of it between special and general. It will depend also on the balance of payments needs of Russia for 1995 and the quality of the program we will negotiate with them this fall.

Will we have a stand-by in place this fall? I don't know. In view of the quality of our work with the Russian authorities since the beginning of this year, and their steadfastness in trying to maintain and develop progress on the monetary and fiscal side, as well as on the structural side, I am hopeful that we will be able to have a successful negotiation.

Camdessus: if an SDR allocation is not relevant today, when would it be relevant?

QUESTION: *I had the feeling that the Group of 7 endorsed the selective SDR allocation to give the 37 countries a fair share. Did the Group of 7 miscalculate its political weight in pushing other countries to accept a selective increase?*

CAMDESSUS: The SDR appears twice in a different context, not always in similar language. This, I presume, reflects a kind of uneasiness in the Group of 7 or their sherpas with this instrument and the present state of discussions on it.

I will take it very positively. The Group of 7 knows that you need an 85 percent majority to have an allocation, and that means a lot of countries in transition and in development voting for it.

Let us imagine that at this stage we have only a special allocation of SDRs. I would be concerned that this would give the world the impression that, even in circumstances comparable to those in which we are today, a general allocation of SDRs is not relevant. But if it is not relevant today, when would it be relevant? Allocating SDRs to the small group of newcomers against that background would mean that we are giving them a stake in an instrument at its terminal stage. I would not easily see the interest of such a contribution to countries in transition.

A lot of horse trading will still be needed; but at the end of the day, it will culminate in the adoption of a package in which everyone finds things they would have preferred not to see, but which are necessary for a broad global consensus on a major contribution to the world's health during the next few years. ■

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